S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **Consumers Energy Company** for approval of a Gas Cost Recovery Plan and authorization of Gas Cost Recovery Factors for the 12-Month Period April 2011 – March 2012.	))))))	Case No. U-16485

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on September 12, 2011.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before October 3, 2011, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before October 20, 2011. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Sharon L. Feldman

Digitally signed by Sharon L. Feldman
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Sharon L. Feldman
Administrative Law Judge

September 12, 2011
Lansing, Michigan

S T A T E O F M I C H I G A N

MICHIGAN ADMINSTRATIVE HEARING SYSTEM

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

I.

PROCEDURAL HISTORY

This Proposal for Decision addresses Consumers Energy Company's December 28, 2010 application for approval of its Gas Cost Recovery Plan and factors for the GCR year April 1, 2011 through March 31, 2012. The company's filing projected total GCR costs of $1,099,534,000 for the GCR year, with a GCR ceiling factor of $6.4545 per Mcf, further subject to a contingency adjustment, presented a five-year forecast, and included the testimony and exhibits of five witnesses.

At the February 2, 2011 prehearing conference, Staff and Consumers Energy appeared, and intervention was granted to the Attorney General, the Residential Ratepayers Consortium (RRC), and the Michigan Community Action Agency Association (MCAAA). According to the established schedule, on April 20, 2011, the Attorney General, the RRC, and the MCAAA filed the testimony and exhibits of one witness each; on May 9, 2011, Consumers Energy filed the rebuttal testimony and exhibits of four witnesses. At the May 17 and 18, 2011 evidentiary hearings, eight witnesses testified and were cross-examined. All parties filed briefs on June 15, 2011, and reply briefs on July 6, 2011. Also, on May 25, 2011, Consumers Energy filed a request for correction of the transcripts; no party filed a response.

An overview of the record is provided in section II below; disputed issues involving the company's gas purchasing plans for future GCR periods are discussed in section III; the monthly gas sales forecasting methods are discussed in section IV; the GCR contingency matrix is discussed in section V, and affiliate transaction issues are discussed in section VI. Transcript corrections are addressed in section VII.

II.

OVERVIEW OF THE RECORD

The evidentiary record is contained in 494 pages of transcript and 51 exhibits.

Consumers Energy presented the testimony of the following witnesses: Shawn D. Burgdorf; Hubert W. Miller III[1], Lori M. Harvey, David W. Howard, and Erin A. Rolling. Mr. Burgdorf testified to the company's activities in federal administrative proceedings before the FERC to minimize interstate pipeline transportation costs. A list of the various pipeline regulatory proceedings Consumers Energy has intervened in, by the docket, pipeline, and subject matter, is presented in his Exhibit A-1.

Mr. Hubert W. Miller III presented the weather-normalized sales and transportation forecast volumes for the plan year and five-year forecast period,

[1] Mr. Hubert W. Miller III adopted direct testimony originally filed by Linda J. Clark, who subsequently retired from Consumers Energy.

approved by Consumers Energy management as of September 2010. He explained that the forecasting process relied heavily on regression analysis along with professional judgment. Fifteen years of data were used to make the weather-normalization adjustments. Monthly forecasts were derived from annual forecasts using monthly consumption data over the four-year time period 2006-2009. His Exhibits A-2 through A-12 present calendar and cycle-billed sales and transportation forecast volumes, while historical weather-normalization information and major economic assumptions are presented in Exhibits A-13 through A-15. Mr. Miller also presented rebuttal testimony as discussed below.

Ms. Harvey testified regarding the company's cold-weather planning, including the design peak day, and expected storage utilization. She explained that the company is using a "4% probability planning basis", which is equivalent to a one-in-25-year rate of insufficient supply. This requires the company to plan to meet 13% additional heating degree days above the 15-year winter average. Ms. Harvey also testified to the contingency ceiling mechanism the company is proposing, modeled on the mechanism approved in Case Nos. U-15704 and U-16149. She presented Exhibits A-16 through A-21, but also discussed the colder-than-normal weather supply planning for five different scenarios shown in Mr. Howard's Exhibit A-35. Ms. Harvey's rebuttal testimony is discussed below.

Mr. Howard described the contractual arrangements in place for gas supply and transportation for the GCR year. He testified extensively regarding the company's fixed price purchase strategies, including a review of the history of these guidelines as well as the company's proposed modifications, and the underlying analysis. The proposed fixed price strategies are presented in Exhibits A-23 and A-24, with historical price information in Exhibits A-22 and A-27, and the results of the company's analysis presented in Exhibits A-25 and A-26.

Mr. Howard described the company's existing fixed price gas purchases for the 2011-2012 GCR year, shown in Exhibits A-28 and A-33, and explained that fixed price purchases totaling 63% of the company's anticipated supply needs for this GCR year have already been made. Forecast NYMEX prices for the balance of supplies to be purchased for the GCR year are presented in Exhibit A-34. Mr. Howard also described the transportation contracts in place, including firm and interruptible transportation rates, reflected in Exhibits A-31 and A-32. He testified that the company is planning to let its current contract with Great Lakes expire, in favor of purchasing incremental load at the utility's city gate.

Mr. Howard's Exhibit A-29 shows planned acquisitions per month for the plan period and the five-year forecast period. He testified that a weakened economy, increased conservation, and a significant increase in GCC participation led to a reduction in forecast volumes for the plan year. He testified that the company's plan assumes GCC suppliers will provide approximately 48 Bcf in gas supplies.

Mr. Howard further testified regarding the diversity and flexibility of supply incorporated in the company's plan, including the company's reliance on its storage operations to meet normal and peak winter supply requirements. His Exhibit A-30 illustrates the sources of supply by basin under normal weather, and by season. Mr. Howard echoed Ms. Harvey's testimony regarding the company's planning to meet a design peak day, and for colder-than normal weather. Exhibit A-35, discussed above, shows the resources in place to meet different winter weather scenarios, and Exhibit A-36 shows graphically levels of protection for colder-than-normal weather.

Exhibit A-37 shows the company's planned utilization of its storage capacity. Mr. Howard testified that the storage assets are used in an efficient manner, with reference to Ms. Harvey's testimony regarding storage operations. And he testified that the company's plans for gas acquisition in March are reasonable and prudent, and that it would not be appropriate to delay March purchases beyond the beginning of the month.

Mr. Howard's rebuttal testimony is discussed below.

Ms. Rolling testified to the company's proposed GCR factor calculation, including the base factor as well as the company's proposed contingent mechanism to adjust the ceiling factor based on changes in NYMEX prices. The GCR factor calculations are presented in Exhibit A-38, with the tariff sheets reflecting the base factor and the contingent adjustment mechanism in Exhibits A-39 and A-40.

The MCAAA's witness, Mr. William A. Peloquin, testified regarding the contingent price adjustment mechanism, recommending that it be discontinued for a variety of reasons including stable gas price forecasts, and the burden to ratepayers. He also testified that Consumers Energy should be evaluating future changes in the natural gas market driven by increased reliance on natural gas for electric generation. Mr. Peloquin testified that the result of increasing reliance on natural gas for electric generation will be higher summer prices for natural gas, with "valleys" in the months of April/May and September/October, and that Consumers Energy should consider this in planning to operate its storage fields. Additionally, Mr. Peloquin testified regarding the potential harm from affiliate transactions, and recommended that the Commission adopt additional safeguards to protect ratepayers. Exhibit MCAAA-1 shows many of Consumers Energy's affiliates.

Mr. Frank J. Hollewa testified to his review of the company's plan for the RRC. He testified that Consumers Energy's fixed price purchase guidelines provided for too high a percentage of fixed price purchases. He compared Consumers Energy's gas costs over a five-year period to market prices at the time of delivery and concluded Consumers Energy paid $1.25 billion above market prices at the time of delivery, with net savings in only one of the five years (2008-2009). He presented Exhibit RRC-1 to show an upward bias in the futures market, and further testified that the limited number of NYMEX trades two or three years in advance of delivery limits the reliability or predictability of these prices. Acknowledging that the company lowered the level of fixed price purchases using the "quartile" method in its fixed price purchase guidelines, he recommended the annual caps on those fixed price purchases be further reduced for purchases two and three years out. And he recommended elimination of the "tier" strategy for fixed price purchases under the guidelines, viewing purchases at fixed prices just prior to the start of the GCR year as "speculation".

Additionally, Mr. Hollewa took issue with the company's bidding process, indicating that he reviewed approximately 20 of the company's fixed price purchases for which the company did not receive at least three bids. He recommended that the company revise its bidding process, and further recommended that bids for the "basis" component of the delivered price be solicited first, and then the "NYMEX" component, so that NYMEX bids could be evaluated during the "pit" trading session.

Finally, Mr. Hollewa testified regarding the company's sales forecasts. He noted that the company used data over a four-year period to break its annual projections into monthly projections, even though the Commission adopted an eleven-year period in Case No. U-16149. He testified that it does not make any material difference in this case, but recommended that the company be required to provide calculations using both data sets in future plan cases, following the format of discovery responses presented in Exhibit RRC-2.

The Attorney General's witness, Mr. Ralph E. Miller, also presented recommendations regarding the company's plan, also focusing on the fixed price purchase guidelines. First, he testified that the company's proposed guidelines exclude language that was included in prior versions requiring the company to exercise discretion in implementing the guidelines. Citing risks of changes in customer usage and market conditions that would be shifted to ratepayers, he recommended that the omitted language be restored.

He also recommended that the Commission approve the guidelines for use only until June 2012, i.e. until the approximate time that parties to the GCR plan case for the GCR year 2012-2013, would have had an opportunity to review the company's plan. Regarding the specific purchasing strategies, he recommended excluding the tier strategy from the guidelines, and reducing the quantities of fixed price purchases at the second quartile level.

Mr. Miller addressed Consumers Energy's claim that its fixed price purchase guidelines provide for reasonable and prudent pricing. He testified that the "second quartile" prices do not present a favorable opportunity for the company to purchase gas.

He identified a change in the market beginning approximately 2006, testifying that year-out futures prices jumped relative to the prompt month prices. His Exhibits AG-1 and AG-2 show NYMEX prices relative to quartile ranges over the last eight years. He also critiqued Consumers Energy's analysis of its fixed price purchasing strategies, characterizing the company's analysis as a good first step, but contending that the study results were biased in favor of fixed price purchases.

In his rebuttal testimony, Mr. Howard responded to Mr. Ralph E. Miller's and Mr. Hollewa's testimony that the tier strategy should be eliminated from the guidelines, citing the Commission's decision in Case No. U-16149, and U-15704, and contending the strategy provides price stability. He also objected to Mr. Miller's recommendation that the guidelines expire in June 2012, relying on the extension of the guidelines by an additional year in Case No. U-15704, and asserting that the company's proposed modifications will help lower costs more quickly than current purchase levels if prices continue to decline, while protecting customers against volatility. He disagreed with Mr. Miller's critique of the company's study of various quartile fixed price purchase levels, and contended that second quartile purchase caps should not be reduced because they provide a favorable opportunity to purchase gas.

Mr. Howard also addressed Mr. Hollewa's testimony, contending that price minimization is not a more important goal than minimizing price volatility and risk. Again relying on the Commission's decisions in Case Nos. U-15704 and U-16149, he disagreed with many of Mr. Hollewa's characterizations of the NYMEX market prices and current market conditions. And regarding the company's bid solicitation, he testified that the company solicits "composite" bids with both NYMEX and basis prices, and characterized the idea of “pre-triggering” either component price as a speculative attempt to outguess the market price. He also did not see value in limiting trading to pit hours.

Finally, Mr. Howard addressed Mr. Peloquin’s testimony regarding affiliate transactions, testifying that Consumers Energy does not purchase natural gas from or sell natural gas to any of its non-regulated affiliates, and the company’s plan does not include any affiliate transactions.

Mr. Hubert W. Miller presented rebuttal testimony in response to Mr. Hollewa’s proposal to require the company to provide its monthly forecast results in the next plan case using both four-year and eleven-year data sets. In his view, the information necessary to perform the eleven-year calculation is already provided and discovery is available.

Ms. Harvey’s rebuttal testimony responded to Mr. Peloquin’s testimony that the company should analyze the use of “valley purchasing” in operating its storage system. She testified that the company should not be required to perform analyses for other parties, and identified numerous problems with Mr. Peloquin’s proposal, including practical planning and operational limits.

Ms. Rolling also testified in rebuttal to Mr. Peloquin, addressing his recommendation to eliminate the contingent pricing mechanism. She testified that Mr. Peloquin was mistaken in certain assumptions, and disagreed that delaying cost recovery benefits customers. She testified that although market prices have fallen, the lower prices do not mean less volatility or less need for the contingent pricing mechanism.

The parties' briefs generally follow the testimony of their witnesses. Consumers Energy asks that the Commission approve its plan and proposed factors, including its proposed ceiling price adjustment (contingency) mechanism, and its proposed fixed price purchasing guidelines, and to evaluate its five-year forecast of gas requirements, anticipated sources of supply, and cost projections and determine that there are no items, on the basis of present evidence, the Commission would be unlikely to permit the company to recover in the future. The RRC proposes modifications to the fixed price purchasing guidelines consistent with Mr. Hollewa's testimony, and additionally requests the Commission to require the company to present the eleven-year monthly sales allocation analysis. The Attorney General proposes modifications to the fixed price purchasing guidelines consistent with Mr. Ralph E. Miller's testimony, including an expiration date for the guidelines, elimination of the tier strategy, and modification of the annual caps, and the Attorney General recommends discontinuing the contingency mechanism. The MCAAA requests that the contingency mechanism be discontinued, as Mr. Peloquin testified, and argues the Commission should require the company to provide an analysis of changes in gas markets and the potential for "valley purchasing". The MCAAA also asks the Commission to provide for enhanced reporting and review of affiliated transactions, based on Mr. Peloquin's testimony regarding "ring-fencing" policies and their benefits. Staff supports modifying the fixed price purchase guidelines to ensure the company retains discretion in administering the guidelines, calls for further evaluation of those guidelines, and otherwise recommends that the Commission approve the company's application.

III.

GAS PURCHASING STRATEGIES

As indicated above, the parties' briefs raise several issues for resolution in this proceeding relating to the company's gas purchasing strategies.

A. FPP Guidelines--overview.

Consumers Energy has had fixed price purchase or "FPP" guidelines in place at least since company's 2001-2002 GCR plan case, Case No. U-12752, although the guidelines have been modified in subsequent plan cases. There are two main parts to the current guidelines, a "tier" strategy and a "quartile" strategy.

The purpose of the quartile strategy is to identify favorable opportunities for the company to enter into fixed price contracts for natural gas one or more years into the future. In this strategy, each month, current NYMEX price projections are compared to historical NYMEX values.[2] When current price projections looking one or more years into the future are below the median of the historical values, the guidelines identify target for the company to purchase, stated as percentages of the company's expected GCR requirements for any given year. The purchase targets vary depending on how far below the applicable median the current NYMEX prices fall, by quartile, and how far away the delivery period is. In addition to the monthly purchase targets, for each year there are purchase limitations referred to as the annual caps. Consumers Energy is proposing to revise both the monthly purchase targets and the annual caps to the levels presented in Exhibit A-23.

[2] The historical values are the most recent 36 NYMEX 12-month average strip prices, with each average moving one month from the prior average, thus spanning a 47-month time period.

The purpose of the tier strategy is to ensure at least a certain percentage of gas is purchased at fixed prices both before the start of the GCR year and at certain intervals within the GCR year. Consumers Energy is not proposing any changes to the tier strategy approved in Case No. U-16149, the company's plan case for the preceding (2010-2011) GCR year. Based on quartile purchases made under the current guidelines, Consumers Energy also acknowledges that the tier percentages have already been met for this GCR year and for the next.

Before turning to the specific elements of the strategies in dispute, a review of the requirements of Act 304 is in order. Under MCL 460.6h(3), a plan must describe all major contracts and gas supply arrangements entered into by the utility for obtaining gas during the specified 12-month period:

> The description of the major contracts and arrangements shall include the price of the gas, the duration of the contract or arrangement, and an explanation or description of any other term or provision as required by the commission. The plan shall also include the gas utility's evaluation of the reasonableness and prudence of its decisions to obtain gas in the manner described in the plan, in light of the major alternative gas supplies available to the utility, and an explanation of the legal and regulatory actions taken by the utility to minimize the cost of gas purchased by the utility.

Under MCL 460.6h(4), Consumers Energy is also required to file: "a 5-year forecast of the gas requirements of its customers, its anticipated sources of supply, and projections of gas costs." The forecast must include:

> a description of all relevant major contracts and gas supply arrangements entered into or contemplated between the gas utility and its suppliers, a description of all major gas supply arrangements which the gas utility knows have been, or expects will be, entered into between the gas utility's principal pipeline suppliers and their major sources of gas, and such other information as the commission may require.

Act 304 then specifies the Commission’s obligations in reviewing the plan and the five-year forecast. MCL 460.6h(6) addresses review of the plan:

> In its final order in a gas supply and cost review, the commission shall evaluate the reasonableness and prudence of the decisions underlying the gas cost recovery plan filed by the gas utility pursuant to subsection (3), and shall approve, disapprove, or amend the gas cost recovery plan accordingly. In evaluating the decisions underlying the gas cost recovery plan, the commission shall consider the volume, cost, and reliability of the major alternative gas supplies available to the utility; the cost of alternative fuels available to some or all of the utility's customers; the availability of gas in storage; the ability of the utility to reduce or to eliminate any sales to out-of-state customers; whether the utility has taken all appropriate legal and regulatory actions to minimize the cost of purchased gas; and other relevant factors. The commission shall approve, reject, or amend the 12 monthly gas cost recovery factors requested by the utility in its gas cost recovery plan. The factors ordered shall be described in fixed dollar amounts per unit of gas, but may include specific amounts contingent on future events, including proceedings of the federal energy regulatory commission or its successor agency.

MCL 460.6h(7) addresses review of the five-year forecast and expected sources of gas supply:

> In its final order in a gas supply and cost review, the commission shall evaluate the decisions underlying the 5-year forecast filed by a gas utility pursuant to subsection (4). The commission may also indicate any cost items in the 5-year forecast that on the basis of present evidence, the commission would be unlikely to permit the gas utility to recover from its customers in rates, rate schedules, or gas cost recovery factors established in the future.

Principally addressing the intervening parties’ testimony on the fixed price purchase guidelines, Consumers Energy argues that the parties are attempting to deprive the company of its statutory right to a decision from the Commission as to the reasonableness and prudence of its plan. Thus, Consumers Energy argues in its reply brief, in the context of discussing Staff’s arguments favoring the exercise of discretion by Consumers Energy in implementing the guidelines:

> Act 304 requires that the Commission determine in this case whether it views Consumers Energy's Plan as reasonable and prudent, and if not, identify areas of disagreement and amendments that should be made. These are not issues that lawfully can be deferred by the Commission to the reconciliation case. If a party to this case has a specific disagreement with the proposed GCR Purchasing Strategy, and how it balances the various considerations (such as cost of gas considerations), that disagreement must be raised and addressed in the Plan case.[3]

Consumers Energy further argues regarding the guidelines:

> Consumers Energy has reviewed and recommended revisions to Gas Purchasing Strategy Guidelines which it believes to be responsive to, and in accordance with, The Commission's guidance in orders issued in Case Nos. U-15704 and U-16149. Consumers Energy requests that the Commission review and approve the Company's GCR Plan, finding that the decisions underlying the Plan are reasonable and prudent.[4]

Consumers Energy's briefs suggest that it considers the Gas Purchasing Strategy Guidelines part of its "plan":

> The Commission should, as Act 304 contemplates, evaluate the reasonableness and prudence of the decisions underlying the gas cost recovery Plan, including the Gas Purchasing Strategy Guidelines, and approve, disapprove, or amend the Plan accordingly.[5]

Raising a related issue in its reply brief, the RRC objects that the multi-year term of the guidelines deprives the Commission of its ability to review the company's plan:

> [MCL 460.6h] requires that in its GCR Plan, Consumers include its "evaluation of the reasonableness and prudence of its decisions to obtain gas in the manner described in the plan, in light of the major alternative gas supplies available to the utility." Because of the FPP guidelines, no such evaluation takes place. By the time the GCR Plan is filed, the Company has already secured its FPP gas for the GCR Plan year. For the FPP purchases, there is no consideration of the major alternative gas supplies available to the utility in the GCR Plan year, i.e., the market price of gas in the GCR Plan year becomes irrelevant.[6]

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[3] See Consumers Energy reply brief, page 13.
[4] See Consumers Energy reply brief, page 14.
[5] See Consumers Energy reply brief, page 10.
[6] See RRC reply brief, page 3.

To the extent the guidelines cover purchases to be made for the 2011-2012 GCR year at issue in this case, the Commission approves, disapproves, or modifies them in accordance with MCL 460.6h(6). For this GCR year, though, the portion of the proposed guidelines that on its face appears to apply this GCR year does not actually reflect the plan Consumers Energy has followed in purchasing gas for this GCR year. Instead, the company's plan is to rely on the gas purchasing strategies previously reviewed by the Commission, including the purchases shown in Exhibit A-28, and to use the proposed guidelines on a "go-forward basis" only.[7] As shown in Exhibit A-29, the company had already made fixed price purchases of 63.5% of its expected requirements for this GCR year by December of 2010.[8] Moreover, the parties do not take issue with the portion of the company's proposed quartile purchasing strategy applicable to this GCR year, and all acknowledge that the tier purchasing strategy will not be applicable.

But to the extent the guidelines cover future GCR periods, they are part of the five-year forecast and identify the expected sources of gas supply for the five-year period. In this context, the Commission need not "approve, disapprove or amend" as Consumers Energy argues it is required to do, but instead need only evaluate the five-year forecast, and "may also indicate any cost items in the five-year forecast that on the basis of present evidence, the commission would be unlikely to permit the gas utility to recovery from its customers."

This context is important to bear in mind in evaluating the parties' arguments regarding the fixed price purchasing strategies. As discussed in subsection B below,

[7] See, e.g., Howard 3 Tr 302, 303.
[8] The company has already exceeded the annual caps in the proposed guidelines for this GCR year for all fixed price purchases except for purchases below the first quartile. See 3 Tr 304.

one point of dispute between the parties is the extent to which the guidelines should require the exercise of discretion by Consumers Energy. Staff, the RRC, and the Attorney General object to the company's proposal to delete language addressing this discretion. The Attorney General also proposes that the guidelines expire in June 2012. This proposal is discussed in subsection C below. Turning to the specific guideline strategies at issue, subsection D addresses the RRC's and the Attorney General's recommendation to eliminate the tier strategy; section E addresses their recommended modifications to the annual caps on fixed price purchases under the quartile method. The RRC's concerns with the company's bidding procedures are discussed in subsection F, and arguments raised by the MCAAA regarding the use of a "valley purchasing" strategy and the identification of price spikes are discussed in subsections G and H.

B. Discretion

The fixed price purchase guidelines dating back to Case No. U-12752 included the following language: "It is the responsibility of the Executive Director of Gas Management Services to exercise discretion in administering these guidelines."[9] The revised guidelines Consumers Energy advocates in this case omit this language. Staff, the RRC, and the Attorney General argue that this language should be restored. Mr. Ralph E. Miller testified:

> In the absence of any other explanation, it appears that the Company is asking the Commission to approve the stated FPP targets as minimum quantity floor[s] regardless of any changes that may occur between the time the GCR plan is developed and the time the company makes actual FP purchases. This is not a just or reasonable strategy, and it would shift

[9] See Exhibit 1, page 2, to the Settlement Agreement approved by the Commission's July 25, 2001 order in Case No. U-12752.

> the risk of increased GCR costs to ratepayers. The FPP targets should constitute neither a stand-alone floor nor a stand-alone ceiling that automatically makes actual purchasing decisions reasonable and prudent. The Company should take into consideration all changes in circumstances that occur between the time it develops a GCR plan and the time it makes actual purchases. Two of the most important types of changes that could and should affect actual purchasing decisions are changes in customer requirements and changes in natural gas market conditions. Consumers already considers changes in customer requirements when it implements its Guidelines, and it should also recognize changes in gas market conditions.[10]

In rebuttal, Mr. Howard testified to his belief that the disputed language created confusion, and that the intent of the discretionary language was to allow discretion only as long as the targets are met.[11] He focused on the guideline language for the tier strategy contained in Exhibit A-23:

> The highlighted language in combination with the rest of the language makes clear that if the fixed price percentage is below the target when a monthly review is conducted, the Company is required to implement a buying action plan to move coverage to the stated percentage by the specified date of December 1 of the year preceding the GCR year, by April 1 of the GCR year[, by] July 1 of the GCR year, or by October 15 of the GCR year. While the Company has some discretion to determine where within a percentage range it will target, it is required to take action to be within that range. This understanding has consistently been applied in prior GCR years. [12]

And further:

> The Gas Purchasing Strategy Guidelines . . . specifically state: "as long as the level of coverage is within the target range, further action is discretionary." Thus the guideline targets must be met. As indicated in the language quoted above, there is no discretion in the Tiered Fixed Price Purchase Guideline to plan to purchase less than the guideline targets.[13]

[10] See 2 Tr 203-204.
[11] See 3 Tr 380-382.
[12] See 3 Tr 338.
[13] See 3 Tr 339.

In its reply brief, Consumers Energy also argues that disputed sentence was never intended to suggest that the Senior Vice President had discretion to disregard the guideline purchasing targets: "Rather, it was intended to convey that in the administration of those Guidelines, the Senior Vice President had authority to determine how to meet the Guideline requirements and directives while working within these Guidelines."[14] Consumers Energy further indicates, however, that should the Commission conclude that the sentence should be added back, the appropriate revision would read: "It is the responsibility of the Vice President of Energy Supply Operations to exercise discretion in administering these guidelines."[15]

As noted above, the disputed sentence dates back to the settlement agreement approved in Case No. U-12752, which included only the tier strategy in the guidelines.[16] The sentence appears at the end of the written guidelines, which otherwise use words such as "shall" and "will". The placement of the sentence at the end of the guidelines suggests that notwithstanding use of the mandatory terms, the company has discretion to deviate from the guideline targets. Note, too, that closely following identification of the targets, the guidelines provide: "A decision as to whether or not such target has been achieved will be the judgement (sic) of the Executive Director of Gas Management Services." If the disputed sentence at the end of the guidelines approved in Case No. U-12752 meant essentially the same thing, there would be no reason for this sentence at the conclusion of the guidelines. And if the disputed sentence was intended to mean that the Executive Director had discretion in determining how to meet

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[14] See Consumers Energy reply brief, page 21.
[15] See Consumers Energy reply brief, page 21.
[16] See Exhibit 1 to the Settlement Agreement approved by the Commission's July 25, 2001 order in Case No. U-12752.

the targets, it would have been more natural to incorporate this concept with or as part of the earlier provision, such as: "A decision as to whether or not such target has been achieved, or how best to achieve such target, will be the judgment of the Executive Director."

Retention of discretion by the company is appropriate, since circumstances change, and the company is ultimately responsible for the reasonableness and prudence of its decision-making under the circumstances it is facing. As discussed above, the Commission's approval of the company's five-year supply plans is based on the present evidence—Act 304 does not require the Commission to guarantee the company recovery for rote or mechanical adherence to the target percentages several years in advance, without regard to current circumstances. And the company is in the best position to tailor its decision-making to current conditions, at a meaningful time, rather than awaiting Commission review in a plan case. Only the company, not the Commission, can immediately respond to significant market or operational changes that could undermine the legitimacy of the target values.

Thus, while the presumption should be that the company will meet the targets contained in the guidelines, the company should retain the flexibility to deviate from the guidelines should compelling circumstances indicate deviation is appropriate. Therefore, this PFD recommends that the Commission clarify that the company retains responsibility to exercise discretion in the administration of the guidelines. Given the nature of the Commission's review of the five-year forecast, this PFD declines to specify any particular executive at Consumers Energy as responsible for administering the guidelines, since that would ordinarily be a managerial prerogative. The genesis of the language naming the Executive Director of Gas Management Services, as indicated above, was a settlement agreement.

C. Expiration

Mr. Ralph E. Miller explained the basis for his recommendation that the fixed purchase plan guidelines expire by June 2012 as follows:

> [C]onditions in the gas market change too rapidly for any purchasing strategy to be adopted for more than 12 months without being reviewed and evaluated. Consumers' gas purchasing strategy can and should be reviewed again in next year's GCR plan proceeding, and the validity of this year's review should expire when all parties have had the opportunity to submit their testimony in next year's proceeding.[17]

The Attorney General's rationale for selecting the June date turns on the typical timing of a GCR plan case. In a typical case, Mr. Miller noted, the parties should have filed testimony by June 30, so by that point there would be the opportunity for the parties to agree on a modification to the current guidelines.[18] Absent agreement, the company would have to rely only on its discretion in deciding whether to make fixed price purchases. As Mr. Miller explained:

> [W]hen Consumers files its next GCR plan and other parties review it, we should – at that point by June 2012, if we can reach agreement on what should be done, we would have it, and otherwise, we should wait and say that, well, there's nothing to provide for fixed price purchases until the Commission sorts it out because conditions change enough that we don't want to rely on the judgments that we make now to be guiding actions in the summer and fall of 2012.[19]

In response, Consumers Energy argues that the Commission has approved the guidelines in prior plan cases without such limitations, and approval does not foreclose

[17] See 2 Tr 204-205.
[18] See 2 Tr 242.
[19] See 2 Tr 239.

the guidelines from being reviewed in the next GCR plan proceeding.[20] To Consumers Energy, the guidelines are designed to provide a framework for a long-term strategy and should remain in place unless and until changed or superseded in a subsequent plan case.

Consistent with the discussion in subsections A and B above, this PFD does not recommend an expiration date for the guidelines. The guidelines are part of the company's five-year supply planning. The Commission has an opportunity to review the guidelines further in subsequent plan cases. And it is potentially problematic to choose a cut-off date targeted at the middle of a subsequent plan case proceeding, which as Consumers Energy argues, is arbitrary as it relates to what may be going on in the natural gas market. While the Attorney General's concern for the possibility of rapidly changing market conditions is legitimate, as discussed above, this PFD's recommendation that Consumers Energy should explicitly retain discretion for administering the guidelines in the face of potentially significantly different market conditions should ameliorate this concern.

D. Tiered fixed price purchase strategy

As noted above, the primary function of the tier strategy is to ensure specified minimum levels of fixed price purchases by certain dates leading up to and during the GCR year. Exhibit A-23 shows the tier targets as follows:

GCR Period	12/1	4/1	7/1	10/15
April-March	15-20%	25-30%	-	-
Nov-March	-	-	35-40%	50%

[20] See Consumers Energy reply brief, pages 22-23.

As shown, the targets have GCR-period and winter components. The December 1 starting date is the December 1 immediately prior to the start of the April-March GCR year. Thus, the tier strategy section of the guidelines calls for 15-20% of all GCR purchase requirements for the GCR year to be under fixed price contracts by the December 1 prior to the start of the GCR year, and 35-40% of the winter requirements by July 1 of the same GCR year.

A tier strategy has been a component of the company's fixed price purchase guidelines since the Commission approved the settlement agreement in Case No. U-12752, discussed above.[21] The specific provisions have changed over time. Mr. Howard testified that the company recommends no changes to the current tier strategy because:

> [Consumers Energy] believes that the Tiered Fixed Price Purchase Guideline establishes an appropriate range of fixed price contract levels based on logical and seasonal calendar dates and pricing benchmarks. These ranges and benchmarks help provide price stability and reduce price volatility, particularly during the high consumption winter months. Reducing the fixed price contract target levels would reduce fixed price coverage protection in the absence of quartile trigger events.[22]

Both the RRC and the Attorney General argue that the tier strategy should be eliminated from the guidelines, because it will not apply to the company's purchases for this plan year or the next, and because they believe Consumers Energy has failed to demonstrate the strategy is beneficial to ratepayers. The AG and the RRC both base their opposition to the tier strategy in part on the company's past experience with its guidelines, which resulted in natural gas costs over the last five years totaling $1.25

[21] See supra note 16; the fixed price purchase guidelines approved in Case No. U-12752 contained only a tier strategy.
[22] See 3 Tr 315.

billion above market costs at the time of delivery.[23] They contend that the tier strategy contributed to the disparity between the level of GCR costs and the market price of gas at the time of delivery, and removes the incentive for Consumers Energy to minimize the cost of gas, focusing instead on whether target volumes are achieved.[24]

Recognizing that Consumers Energy has already met the tier targets for the 2011-2012 and 2012-2013 GCR years, Mr. Ralph E. Miller testified:

> If Consumers wants to restore a Tiered FPP Guideline to its gas purchasing strategy in time to meet a December 1, 2012 milestone date [for the 2013-2014 GCR year], the Commission should require Consumers to justify this gas purchasing strategy in its GCR plan for 2012-2013, which is due to be filed in December 2011. Until then, the Tiered FPP Guideline is simply unnecessary, and there is no reason for the Commission to allow it in this case merely because such a guideline has been there for many years, especially in view of the dismal results that have resulted from this purchasing strategy in the past.[25]

The Attorney General also presented evidence of an upward bias in NYMEX futures prices. Mr. Ralph E. Miller testified that since 2006, the NYMEX 12-month strip prices have averaged 88 cents above the prices for the current month.[26]

The RRC particularly objects to the following provision of the tier strategy that calls for the purchase of fixed price supplies for the winter period to be expedited in the event that an evaluation of GCR costs on or after April 1 determines that GCR costs are above the authorized GCR factor:

> Each month, as all factors are incorporated into the gas balance and cost of gas program . . . gas purchases will be evaluated. If as a result of this evaluation it is determined an increase in the fixed price percentage is appropriate, the Gas Supply Department will implement a buying action plan that moves coverage to the level required by the guidelines.

[23] See, *e.g.*, Hollewa, 2 Tr 154.
[24] See, *e.g.* RRC brief at 7, reply brief at 6-9.
[25] See 2 Tr 206-207.
[26] See Exhibit AG-2.

> If after April 1 such evaluation results in a GCR factor exceeding the authorized factor, then within 30 days the fixed price coverage level for the Nov-March period shall be accelerated to the July 1 guideline. If after July 1 such evaluation results in a GCR factor exceeding the authorized factor, then within 30 days the fixed price coverage level for the Nov-March period shall be accelerated to the October 15 guideline.[27]

Focusing on this provision, Mr. Hollewa testified:

> Historically, that has turned out badly for the GCR customers. In my opinion, the Tiered FPP has no defensible value and no rational basis for its implementation under existing market fundamentals. It is simply making FPP over three or four months in the Fall and then again the Spring for the next GCR year. These purchases are pure speculation that prices will be higher rather than lower in the future. This may be due to the fact that the genesis of the Tiered purchases occurred during a period of steady price increases. In addition, I believe that Mr. Howard's testimony confirms that there would be limited value for Tiered FPP in today's market, though he is still an advocate for its continued use in the future. By comparison, the Quartile FPP is at least based on the concept of making purchases at historical low levels.[28]

Responding to Mr. Hollewa's testimony, Mr. Howard testified:

> The Tiered Fixed Price Purchase Guideline is not based upon an effort to "beat the market" or fix gas at a predetermined price trigger. The Tiered Fixed Price Purchase Guideline recognizes the need to provide as much price stability as possible, particularly during high consumption winter months. The Guideline helps mitigate price volatility and risk. . . As ordered by the Commission in the December 21, 2010 U-16149 Order, the Company has evaluated the strengths and weaknesses of the Gas Purchasing Strategy Guidelines and has proposed logical modifications based on the Company's experience as provided in Exhibit A-23. . . and explained in my direct testimony.[29]

Mr. Howard further explained why he believes the company's evaluation of its purchasing strategies supports use of the tier strategy:

> The Tiered FPP guideline provisions were included as part of each strategy and Tiered FPP purchases were made uniformly in each strategy, as appropriate. The results of the weighted pricing scenarios indicated that scenarios that used a combination of Quartile Fixed Price

[27] Exhibit A-23, page 2.
[28] See 2 Tr 160.
[29] See 2 Tr 340.

> Purchases in combination with Tiered Fixed Price Purchases provided a greater possibility of lower cost gas than the strategy that used only Tiered Fixed Price purchases.[30]

Mr. Howard also took issue with the contention that the difference between the company's gas costs and the market prices at the time of delivery were attributable to the tier strategy:

> Mr. Hollewa did not cite when accelerated purchases occurred under the Tiered Fixed Price Purchase Guideline or the dollar impact on the GCR customer as a result of accelerating purchases. Mr. Hollewa has no basis for his claim.[31]

In support of the tier strategy, Consumers Energy also relies on the Commission's decisions in Case Nos. U-16149[32] and U-15704[33], contending the Commission has consistently supported including the tier strategy in the guidelines. To Consumers Energy, there has been no material change in facts or law that provides a basis to reject continuation of the strategy.[34] Staff supports including the tier strategy in the guidelines, as long as the discretionary language discussed in section B above is restored.

A review of the Commission's decisions in Case Nos. U-16149 and U-15704 shows that the Commission recently declined to eliminate the tier strategy from the fixed price purchase guidelines, but called for further evaluation of the guidelines. In Case No. U-15704, Consumers Energy's 2009-2010 plan case, the Commission adopted the company's proposed guidelines with the modifications recommended by

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[30] See 2 Tr 343.
[31] See 3 Tr 354.
[32] See December 21, 2010 order, pages 8, 13.
[33] See March 2, 2010 order, pages 11, 18.
[34] See Consumers Energy reply brief, pages18-19; Consumers Energy initial brief, pages19-21.

Staff, rejecting the Attorney General's recommendation to eliminate the tier strategy, but encouraged the parties to examine the issues further:

> The Commission observes that Consumers' purchasing guidelines were developed at a time when gas costs were trending upward and that the guidelines do not perform as well in the unstable market that the utilities have faced in recent years, and may continue to face for some years to come. The modifications to the purchasing guidelines adopted here begin to address the issues that arise in a volatile market, nevertheless, the Commission finds that the parties should be encouraged to engage in discussions designed to identify changes to the guidelines that may be implemented in future GCR plan years.[35]

The Commission echoed this request in Consumers Energy's 2010-2011 plan case, again rejecting elimination of the tier strategy along with other modifications to the fixed price purchase guidelines, but explaining:

> The fixed price purchase guidelines were approved on March 2, 2010, and the Commission agrees with the Staff that they should remain in place long enough for the company and the parties to be able to evaluate their strengths and weaknesses and propose logical modifications based on experience. The Commission finds that the current purchasing guidelines should remain in place for the 2010-2011 plan year.[36]

In his testimony in this case, Mr. Howard expressly acknowledged that the company undertook an evaluation of the fixed price purchase strategies in response to the Commission's invitations in Case Nos. U-15704 and U-16149.[37]

Based on these decisions, this PFD concludes that the Commission expected the issue of the tier strategy to be revisited in subsequent cases. The company's analysis in response to the Commission's invitation correspondingly invites review of the strategy. It is therefore inappropriate to reject the Attorney General's and RRC's arguments simply on the basis of the Commission's past decisions.

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[35] March 2, 2010 order, page 18.
[36] See Case No. U-16149 (December 21, 2010 order), page 13.
[37] See 3 Tr 297, 340.

Consumers Energy uses the fact that the tier strategy will not be applicable until at least the 2013-2014 GCR year as justification for leaving it in place; conversely, the RRC and the Attorney General argue that because it will not be used, it can be eliminated unless and until further justification is provided. Without resolving these opposing views, because the company will not rely on the tier strategy in the plan year, it is reasonable to conclude that the tier strategy should be reviewed under MCL 460.6h(7) rather than MCL 460.6h(6). Thus, the Commission is required to evaluate the strategy, and may indicate on the basis of present evidence cost items it would be unlikely to permit the utility to recover in the future.

In evaluating the strategy, it is appropriate to begin with the company's analysis. As Mr. Howard explained, the company's analysis tested various quartile strategies in combination with the tier strategy, and tested the tier strategy alone. The results of the different purchasing strategies are shown in Exhibits A-25 and A-26. None of the quartile strategies were tested without the tier strategy, however. Thus, the company's analysis does not validate the tier strategy. Moreover, the results showed the tier strategy performed the most poorly of all strategies under both sets of pricing patterns: it had the highest "average" price and the "overall maximum high" price as shown on page 2 of Exhibits A-25 and A-26. Thus, the company's own analysis provides a reason to be concerned with the tier performance.

As noted above, there are two components to the tier strategy. The first component sets targets for a minimum percentage of fixed price purchases at various times just before and during the GCR period. Focusing on this component, although the company's study does not validate the tier strategy, the Commission has generally recognized that it is reasonable and prudent for the utility to have some level of fixed price supply, and this component of the tier strategy reflects simply that. Thus, even though the tier strategy alone performed poorly in the company's test, and even though the company did not test the variations of the quartile percentage targets with and without the tier strategy to determine whether the tier strategy adds value, this PFD cannot conclude that the Commission would likely disapprove purchases based on this component of the tier strategy, within the context of MCL 460.6h(7). Consistent with the discussion in subsections A and B above, the company should retain discretion in making those purchases to assess the market conditions at the time of the purchases.

The second component of the tier strategy accelerates the fixed price purchases if, after the April 1 start of the GCR year, it appears that the company's total GCR costs exceed the authorized factor. The parties seem to agree that the purpose of this provision is to identify a "rising market" in the middle of the GCR year, as the basis for the accelerated fixed price purchases. Mr. Howard testified, however, that although this provision has been part of the guidelines since approximately 2001-2002, it has never been used.[38] A review of the guideline language quoted above also indicates that other factors, in addition to rising prices, could trigger the accelerated purchases. Any factor that would cause the company's GCR cost estimates to be understated or sales estimates to be overstated could trigger the accelerated purchases, including e.g. a reduction in sales requirements due to unexpected conservation, the unanticipated movement of customers to the GCC program, or an unanticipated increase in pipeline transportation costs. These factors are wholly unrelated to what is going on in the market for natural gas.

[38] See 3 Tr 375-376.

Moreover, although the company's analysis included the tier strategy, it does not appear that the company's analysis tested or could have tested this second component of the tier. If it had, the company would have needed to make certain assumptions about the GCR factor approved for the GCR year being tested, and the change in the component costs and sales each month.

Staff's concern that the company is focusing on maintaining price stability to the detriment of minimizing the cost of gas is of particular applicability here.[39] The goal of the second strategy is not to ensure a minimum amount of fixed price purchases in the company's portfolio, but to purchase gas strictly in response to a potential underrecovery, even if the purchases end up exacerbating any underrecovery. For these reasons, this PFD recommends that the Commission find that reliance on the second portion of the tier guidelines has not been shown to be reasonable and prudent, and the company should be cautioned that accelerated tier purchases are not likely to be deemed reasonable and prudent if they are made only because at the time of the purchases, the company is estimating GCR costs above its currently authorized GCR factor.

Additionally, this PFD notes that although the company has identified a framework for analysis, it has not analyzed potential variations in the tier target percentages. Consistent with recommendations regarding the quartile strategies discussed below, this PFD recommends that Consumers Energy continue to evaluate the reasonableness and prudence of its guidelines, including the tier strategy, in keeping with the Commission's decision in Case No. U-16149.

[39] See Staff brief, page 9.

E. Quartile Purchases

The "quartile" strategy forms the second part of Consumers Energy's current and proposed fixed price purchase guidelines. As a result of its analysis, Consumers Energy recommends modifications to both the monthly and annual caps on quartile purchases.

Mr. Howard explained that the company tested four different quartile strategies, each in combination with the tier strategy: the current plan, also characterized as "90/60/60" based on the annual percentage caps on purchases for the first three years; a strategy with annual caps of "80/50/50" and certain reduced monthly quartile purchase targets; the "50/40/30" strategy the company is proposing in this case; and a strategy with significantly reduced annual caps of 10% to 30% for each of the first three years of the plan.[40]

These strategies were tested by comparing the gas costs in the third year of each strategy under various pricing scenarios. As Mr. Howard explained: "The 2013-2014 GCR period was the test period due to the Company having zero fixed price costs in that period currently."[41] The company first used 50 pricing scenarios to test the strategies, some randomly generated and some characterized as "custom", within the price range of $2.05/MMBtu to $10.50/MMBtu. The company next used a subset of these pricing scenarios to test the strategies, selecting the 28 pricing scenarios falling within the narrower price range of $3.00/MMBtu to $7.95/MMBtu. The narrower price range reflects the expected range of prices over the test period based on multiple

[40] These are referred to as the annual caps on second quartile purchases, as discussed in more detail below. See 3 Tr 305-315. Mr. Howard did not provide greater detail on the strategies tested.
[41] See 3 Tr 305.

forecasts. The results from testing the strategies using all 50 scenarios are reported in Exhibit A-25; the results from testing the strategies using the 28 scenarios within the narrower price range are reported in Exhibit A-26.

Mr. Howard explained the company's rationale for selecting the proposed strategy given the study results:

> [W]hen all of the pricing scenarios are evaluated in both studies the resulting numbers show that the proposed strategy has the greatest likelihood of producing a lower cost of gas with a reduced risk of producing the highest cost of gas.[42]

The company's proposed strategy includes monthly purchase targets stated in Exhibit A-23 as follows:

<u>Quartile</u>	Current GCR Year	Second GCR Year	Third GCR Year	Fourth GCR Year
2Q Fixed Price Trigger	10%	5%	5%	
1Q Fixed Price Trigger	15%	10%	10%	5%
<1Q Fixed Price Trigger	20%	15%	15%	10%

And it includes annual purchase caps stated as follows:

<u>Annual Caps</u>	Current GCR Year	Second GCR Year	Third GCR Year	Fourth GCR Year
2 Quartile	50%	40%	30%	
1 Quartile	60%	50%	40%	20%
<1Quartile	70%	60%	50%	30%

[42] See 3 Tr 310.

While no party recommended adjusting the company's proposed monthly purchase targets, the Attorney General and the RRC each recommend reductions in the annual caps. Before turning to the specific recommendations, however, it is appropriate to address an ambiguity regarding the annual caps. As shown above, Consumers Energy presents the annual caps for each year at three levels, one for each quartile. But there is no text in the guidelines explaining how the caps work.[43]

The current quartile strategy was developed in Case No. U-15704, Consumers Energy's plan case for the GCR year 2008-2009. In that case, the company's proposed guidelines were presented in its Exhibit A-22, which also reflected its proposal to extend the guidelines to cover five years.[44] These guidelines contained text, but no chart, addressing the annual caps as follows:

> The maximum percentage of gas purchases in the GCR Year subject to Tiered Fixed Price Purchase and the Quartile Fixed Price Triggers will be capped at 90% of the total GCR requirements for the current GCR year and 60% per year for the second and third GCR years and 40% for the fourth GCR year and 20% for the fifth GCR year. If however the average of the 12 NYMEX natural gas contracts falls below the first quartile, the cap for the second and third GCR years will increase to 70% of the total GCR requirements in that year.[45]

A reasonable interpretation of this language is that the increase in the annual caps would only apply to purchases below the first quartile made after the otherwise-stated annual cap is reached.[46]

Translating the annual caps into chart form only, as Consumers Energy now proposes in its Exhibit A-23, may suggest that the purchase caps shown for each

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[43] There is text explaining the monthly purchase targets. See Exhibit A-23, pages 2-4.
[44] See March 2, 2010 decision, Case No. U-15704, page 26.
[45] See Exhibit A-22 from Case No. U-15704, page 5.
[46] Note that in Case No. U-15704, the Commission rejected adding a fifth year to the guidelines, and limited purchases in the fourth year.

quartile level in any given year are independent, but this is misleading. As stated above, the company's intention as contained in the original language addressing the annual caps was to extend the caps on purchases for the second and subsequent years only to accommodate purchases below the first quartile level. The annual caps would not have permitted the company to purchase 60% of its expected requirements at the second quartile level in the second year, and then an additional 60% (or even 40%) at the first quartile level. This is also clear from the Commission's approval of the guidelines with modifications in Case No. U-15704:

> The Commission also agrees that during the fourth year, Consumers should use the quartile fixed price indicator within the first quartile or below only, and that the company's purchases should be limited to 20 percent of its estimated annual supply requirement. In addition, the Commission adopts the Staff's recommendation that Consumers be authorized to purchase an additional five percent of its estimated annual supply requirement for the first through fourth GCR periods, if the appropriate NYMEX average falls below the first quartile.[47]

Because the guidelines in Exhibit A-23 contain no text addressing the annual caps, it is appropriate to clarify that these recommended annual caps should be interpreted to be consistent with the language from the guidelines in Case No. U-15704. Thus, for example, looking at the proposed guidelines for the third GCR year, Consumers Energy could purchase up to 30% of its requirements based on a combination of purchases under any of the monthly quartile triggers, but could only exceed the 30% annual cap with purchases at or below the first quartile level, and could only exceed the 40% annual cap with purchases below the first quartile level. Put

[47] See March 2, 2010 decision, page 18. Note that no party challenged Consumers Energy's statement of the monthly and annual caps in the current guidelines, although the Commission's decision in Case No. U-15704 could be read to modify the annual caps at below-first quartile levels, rather than the monthly caps.

another way, the “second quartile” annual cap precludes purchases in the second quartile once fixed price purchases at any level have reached the cap amount.

The Attorney General recommends further reducing the annual caps that limit second quartile purchases, based on Mr. Ralph E. Miller’s conclusion that second quartile prices do not present a favorable purchasing opportunity. He testified that under the gas market conditions that have prevailed for the past several years, fixed price commitments for gas to be delivered in future months have become unfavorable in comparison to the prices for gas at the beginning of the month of delivery. His Exhibit AG-1 compares the second quartile range over the period February 2003 through February 2011 to the market prices the company would have paid for gas delivered the following GCR year in the absence of fixed price purchases:

> When the Quartile Triggers FP Guideline was first introduced in 2003, its purpose was to encourage Consumers to make FP purchase commitments at times when the prices that Consumers was contracting to pay for those future purchases might be expected to be favorable. It was believed then that prices in the Second Quartile were favorable FP purchase opportunities, and that belief did temporarily turn out to be correct—but only through the middle of 2006. From mid-2006 through February or March 2008, the prices at the top of the Second Quartile were approximately the same as the prices that could be obtained by avoiding fixed price purchases for the immediately following GCR plan year, and instead waiting to purchase gas for each month of that year in the monthly market. After March 2008, the Second Quartile was so high that Second Quartile FP purchase, and even First Quartile FP purchases, ended up costing much more than Consumers would have spent if it had simply avoided them and purchases all of its requirements in the monthly markets during 2009-2010 and 2010-2011.[48]

One conclusion he draws from this data is that the relationship of the quartile triggers to the market prices changed in early 2006:

> From 2003 through 2005, the 12-month strip prices used in developing the Quartile points were close to the prompt month prices. In other

[48] See 2 Tr 208.

> words, the futures market was indicating that gas for the immediately forthcoming 12-month period could be purchased at approximately the same price as gas for just the current (or "prompt") month. But this relationship changed early in 2006, after hurricane Katrina and other hurricanes disrupted gas supplies in the fall of 2005. Since then, the 12-month strips used in developing the Quartile points have averaged $0.88 per Dth higher than the prompt month prices, which are themselves the first of the 12 prices included in each 12-month strip. From February 2003 through December 2005, the average difference was less than $0.01 per Dth.[49]

Exhibit AG-2 illustrates the difference between the 12-month strip price and the prompt month price over the same time period as Exhibit AG-1, and also shows the top and bottom of the second quartile range over that time period.

Mr. Miller also testified that the company's study was biased in favor of fixed price purchases. He testified to two problems with the study: first, he contended that the random and custom pricing scenarios do not reflect plausible market conditions; second, he contended that the study does not cover an appropriate range of purchasing strategies.

Regarding the pricing scenarios, Mr. Miller testified that only 35 of the scenarios were random, and that the results for these scenarios differed markedly from the results of the other 15 "custom" scenarios, with no explanation for how the custom scenarios were created.[50] As to the random scenarios, he testified that each random price was determined independently of the prior month's price, creating greater volatility than actual market results. He explained:

> This assumed independence affects the results because it ensures that each of the 35 random scenarios will have multiple opportunities to make Second Quartile and even First Quartile purchases before April 2013. On the other hand, it provides much less variation in the average monthly price paid during April 2013 through March 2014 for gas that has not

[49] See 2 Tr 211-212.
[50] See 2 Tr 214.

> been placed under fixed price contracts, because Consumers has assumed that there are 12 completely independent monthly prices for the 2013-2014 GCR plan year. Each pricing scenario thus keeps the cost of monthly purchases close to the average, but it allows many opportunities for the purchase of futures contracts at prices far below the average. This assumed and unrealistic pattern creates a bias in favor of fixed price purchases under the Quartiles method.[51]

He also objected that the random scenarios did not constrain the 12-month NYMEX price to exceed the prompt month price, as reflected in the actual market data since 2006: "Failure to reflect this differential makes fixed price purchases unreasonably and unjustly attractive, and it causes the results for strategies with high Annual Caps to appear better in the study than if the price modeling were more realistic."[52]

The RRC proposes different modifications to the annual caps, recommending caps 10% below the percentages recommended by Consumers Energy, for the second, third and fourth years, for each quartile level.[53] Mr. Hollewa testified that he does not believe fixed price purchase programs will result in lower costs for GCR customers. He presented data showing that NYMEX 12-month projections were higher than NYMEX actual prices in 41 out of 48 months,[54] leading him to identify an upward price bias in the futures market. He also testified that NYMEX projections two and three years into the future are not reliable due to the lower volume of contracts traded. He presented data to illustrate this. Mr. Hollewa further explained his recommendations:

> I would also note that gas prices are anything but static. Annual review and changes to these Guidelines are not only prudent but should be mandatory. For example, I would currently not have any problem with the caps associated with the 1Q or Below 1Q for the Second and Third Years as proposed by the Company. This is because the 1Q would approximate the current strip average for the 2011-2012 GCR Year and

[51] See 2 Tr 214-215.
[52] See 2 Tr 215.
[53] See 2 Tr 162.
[54] See Exhibit RRC-1.

> exceed the 2010-2011 actual NYMEX average by approximately $0.44 and the 2009-2010 actual NYMEX average by approximately $0.48. By contract, purchases at the 2Q level would be approximately $0.50 higher than the preceding amounts and would double the risk of purchasing at too high a price. However, the reality is that the Company has already fixed the price of 63% for the Current Year and 60% for the Second GCR Year, simply because this was permitted under previous Guidelines. I believe that it is extremely important to evaluate the potential upside and downside relating to current events and prices when making decisions relating to FPP.[55]

In his rebuttal testimony, Mr. Howard disputed that second quartile prices are not favorable opportunities to purchase gas.

> The upper and lower limits of the Second Quartile are determined each month and can change each month. The Company's reduction of proposed second quartile monthly fixed price triggers percentages for the current year to 10% and for years two and three to 5% recognize that second quartile prices are less favorable than first quartile or below first quartile prices. While prices in the second quartile are less favorable than prices in the first quartile or below, in a rising market Second Quartile purchases provide a favorable opportunity to purchase gas.[56]

Defending the company's analysis of various fixed price purchasing strategies, Mr. Howard disagreed with Mr. Miller's testimony that the pricing scenarios used were not plausible:

> The purchasing strategies used in the model covered a period of March 2011 through March 2014. No one can predict with certainty what prices will be in the future. Prices used in the study have been projected three years into the future. Because of this, the Company evaluated five strategies using 50 random and customer pricing scenarios. As stated in my direct testimony on page 15, the Company performed two studies, one with a range of projected prices from $2.05/MMBtu - $10.50/MMBtu and a second study with a range of projected prices from $3.00/MMBtu - $7.95/MMBtu. The narrower range reflects a combination of projected NYMEX prices, projections from CERA (Cambridge Energy Research Associates), PIRA (PIRA Energy Group) and EIA (US Energy Information Administration), which all project prices within a $4.00/MMBtu - $7.00/MMBtu price band through year 2014. The pricing ranges utilized closely reflect price projections of the above referenced energy agencies

[55] See 2 Tr 162-163.
[56] See 3 Tr 344.

> and provide a reasonable and plausible range to use in performing the study. Also the studies include both randomly generated gas prices (within the specified ranges) and various custom price scenarios. Mr. Miller's criticism is not valid.[57]

Further, he testified:

> Sine no one can accurately predict pricing month to month for the next three year period and the NYMEX market has and will continue to experience volatility, it is reasonable to use the approach chosen by the Company. The prices used to generate the expected values of the various purchasing strategies were reasonable and prudent and reflect volatility that can occur in the NYMEX natural gas futures market. Further, a group of custom price scenarios was also included within the studies to capture various pricing trends.[58]

Regarding the difference between NYMEX futures market prices and the current prices that both Mr. Hollewa and Mr. Ralph E. Miller focused on, Mr. Howard testified:

> Mr. Miller in his own direct testimony . . . and on Exhibit AG-1 has shown that from 2003 to 2006 fixed price purchases in the second quartile were lower than the monthly index settled price. This comparison in prices occurred in a rising NYMEX market. The $.88/Dth difference that Mr. Miller discusses is an average difference between 12-month strip prices and monthly index settled prices since 2006, in a declining NYMEX market. Future NYMEX price trends over the next three years may rise, fall or stay but will unlikely stay precisely the same. The company has provided price forecasts in a range of $4.00/MMBtu - $7.00/MMBtu through the year 2014 on page 15 of my direct testimony. These price forecasts indicate a projected rising NYMEX market which could potentially cause 12-month strip prices to be more attractive than monthly index settled prices such as occurred from 2003-2006 as shown on Exhibit AG-1.[59]

Evaluating the company's proposal and the parties' criticisms, it is appropriate to recognize that the Commission has rejected measurements of the difference between the cost of fixed price supplies and the market price of gas at the time of delivery as

[57] See 3 Tr 344-345.
[58] See 3 Tr 346.
[59] See 3 Tr 346-347; also see 3 Tr 351-352.

based on hindsight, and not necessarily an indictment of the fixed price purchase strategy:

> The Commission agrees that Consumers' gas purchasing guidelines are reasonable and prudent for the most part and therefore rejects the changes recommended by the RRC and the Attorney General. As Consumers points out, the guidelines do not serve solely as a means of minimizing the cost of gas, they also serve to mitigate price volatility and risk. The Commission further agrees that the other parties' critiques and recommendations are based on hindsight.[60]

Consistent with this recognition, while the RRC and the Attorney General have identified what appears to be an upward bias in futures market prices compared both to current prices and to future prices at the time of delivery, this does not establish that fixed price purchases should be avoided, nor does it establish a reasonable level of fixed price purchases. As the company argues, the market forces leading to this upward price bias may change.[61] Moreover, neither Mr. Hollewa nor Mr. Ralph E. Miller opposed all fixed price purchases, begging the question of how to establish appropriate limits on those purchases. Mr. Hollewa acknowledged that the company's quartile guidelines are an improvement on the existing guidelines. Neither Mr. Hollewa nor Mr. Miller provided an analysis of the modifications similar to the company's to show the results under different market conditions.

Because the Commission has expressed a preference for a cautious approach to modifying the guidelines, and because Consumers Energy's analysis, though subject to valid criticism, showed better results for the proposed strategy in comparison to strategies with both higher and with lower caps, this PFD recommends that the

[60] See March 2, 2010 decision in Case No. U-15704, page 18.
[61] See Howard, 2 Tr 346-347.

Commission find the company's proposed modifications to the quartile strategy reasonable, as clarified above, with one exception as discussed below.

As part of its proposal, Consumers Energy seeks to raise the cap on purchases below the first quartile in the fourth year of the guidelines from 25% to 30%. As explained above, the company's analysis focused on the third year of the strategy, and therefore did not test the cap levels for the fourth year. Although the Commission approved the extension of the guidelines to a fourth year in Case No. U-15704, the Commission expressly approved purchases capped at 20% in the first quartile, with an extension to 25% for purchases below the first quartile.[62] Consumers Energy proposes to increase the extension for below first quartile purchases to 30%, although its strategy otherwise calls for reducing the annual caps. Mr. Howard did not address the fourth year increase in his testimony, or provide a specific rationale; instead, his testimony refers generally to reductions in the caps, rather than increases.[63] Thus, this PFD recommends that the Commission find that the proposed increase in the fourth-year cap on below-first-quartile purchases is unreasonable.

Nonetheless, this PFD finds that Mr. Miller's criticism of the company's analysis is valid in large part. The company did not fully justify the pricing scenarios used in its analysis. Even though Mr. Miller expressly testified that the company had not explained the basis for the "custom" pricing scenarios, Mr. Howard's rebuttal testimony did not explain how the "custom" scenarios were constructed. Mr. Miller also pointed out that the company's random pricing scenarios assumed that prices would vary randomly

[62] See Case No. U-15704 (March 2, 2010 order), page 18.
[63] See, e.g. 3 Tr 341 ("[A]s shown on Exhibit A-24 . . . the Company has proposed reducing percentages subject to the Quartile Fixed Price Purchase Guideline for the Current, Second, Third and Fourth GCR years in recognition of changes in the market conditions.") See also, 3 Tr 313-314.

each month, with no connection to or dependence on the prior month's price. Mr. Howard's rebuttal testimony does not explain this assumption.

Further, with regard to observed differences in prompt month and 12-month strip prices since 2006, the company has not adequately responded to the Attorney General's analysis. While the company reasonably argues that the 88 cent average difference reflected in Exhibit AG-2 is not uniform and may not continue into later time periods, a more comprehensive analysis would test the company's strategy with pricing scenarios that reflect some difference, as well as pricing scenarios that assume no difference. Thus, this PFD recommends, consistent with the Commission's decisions in Case No. U-16149 and U-15704, that Consumers Energy continue to evaluate its fixed price purchase strategy for review in future plan cases.

F. Bidding procedures

The RRC and the Attorney General raise an issue with the reasonableness and prudence of Consumers Energy's bidding procedures in contracting for fixed price gas supplies. Mr. Hollewa testified that he reviewed the company's purchases, shown in Exhibit A-28, and that for 20 of the purchases, Consumers Energy did not receive at least three bids. He further recommended that Consumers Energy be required to bifurcate its bidding, negotiating the "basis" component of the delivered price before the "NYMEX" component, thus allowing the company to negotiate the NYMEX component during the "pit trading" hours in order to have access to greater price information.

Mr. Howard testified in response to Mr. Hollewa regarding the bifurcated bidding approach, opposing the "triggering" of either component first as "pure speculation and an attempt to outguess the current market price."

In its brief, the RRC asks to defer consideration of the bifurcated bidding approach, but does want the Commission to require Consumers Energy to seek at least three bids for every purchase. The Attorney General supports the RRC's position on bidding, relying on Mr. Hollewa's testimony.

Consumers Energy disputes that Mr. Hollewa raised a concern with the number of bids received.[64] Consumers Energy also argues that it solicits multiple offers from qualified suppliers, and selects the lowest price among the competitive offers, making its bidding procedures reasonable.[65]

First, this PFD finds that Mr. Hollewa did testify to a concern with the number of bids received, as well as with the approach to bid solicitation. Second, Mr. Hollewa's testimony on this point is persuasive, that the company should solicit and take steps to ensure that it is likely to receive multiple bids, if it relies on competitive bidding to establish that it is obtaining the best available price.

No party to this proceeding challenged any of the purchases the company has already made for the 2011-2012 GCR year, so this PFD recommends only that the Commission caution Consumers Energy that if it intends to rely on competitive bidding to justify the reasonableness of its purchase prices, it should ensure it solicits bids from enough market participants to actually result in a competitive bidding process, or be prepared to explain the deficiency.

G. Valley Purchasing

The MCAAA also proposed that Consumers Energy be directed to evaluate "valley purchasing strategies", based on Mr. Peloquin's testimony that increased

[64] See Consumers Energy reply brief, page 23.
[65] See Howard, 3 Tr 356.

national reliance on natural gas to generate electricity will result in higher summer prices for gas:

> Natural gas fueled combined-cycle electric generators have been the primary source of new electric capacity for many years. The MCV is one prime example. Their lower capital cost, high thermal efficiency, lower environment emissions, more than overcame their use of a high cost (per btu) premium fuel. The new low cost abundant supply of shale gas will result in a rapid expansion of natural gas fueled electric generation. Additionally, new coal generation will continue to be depressed by environment concerns and new nuclear generation is now further ham-strung by the DOE's complete breach of its spent nuclear fuel disposal contract plus the Japanese nuclear fiasco.[66]

Mr. Peloquin predicted that the "valley months" between winter and summer peaks (April and May, and September and October) will be the low cost months for the purchase of storage gas. He recommended that Consumers Energy be required to investigate a strategy to increase reliance on such valley purchases:

> The off-peak season for electric generation are the spring months of April/May and the fall months of September/October. [T]his is the period during which nuclear power plants are intentionally taken off-line for refueling and maintenance. Given the constant flow nature of gas production and the valley months of April/May and September/October for both electric generation and other natural gas sales, the valley months will become the low price months for the natural gas industries.
>
> I recommend that Consumers should be required to investigate the benefits of purchasing the majority of its storage gas during the valley months of April/May and September/October. Additionally, injecting the majority of storage gas during the valley months will require changes in their physical plant that should also be investigated.[67]

In rebuttal to Mr. Peloquin's testimony, Ms. Harvey disputed Mr. Peloquin's conclusion that gas prices should be expected to be lower in valley months. She testified to numerous practical and operational constraints that would prohibit

[66] See 2 Tr 258.
[67] See 2 Tr 258-259.

implementing a valley purchasing strategy.[68] Ms. Harvey testified that no formal study was required for her to conclude that the MCAAA's strategy is operationally unsound:

> Purchasing the majority of storage gas during April/May and September/October would be operationally unsound and would result in increased supply and price risks for the Company's GCR customers. Among other things, Mr. Peloquin's suggested purchasing approach does not take into consideration system and operational parameters, the integrated nature of the company's natural gas system, the planning process that occurs through modeling of the entire integrated system, and the need to ensure storage utilization, peak day and monthly delivery requirements for all customer groups are being met within the constraints of the Company's natural gas storage, transmission, and compression system.[69]

Consumers Energy also objects to performing evaluations as part of its GCR filing, and argues the burden of any such investigation should be on the MCAAA.

In its reply brief, Consumers Energy also cites Mr. Peloquin's acknowledgement on cross-examination that there are environmental concerns with the production of shale gas, and that the rapid acceleration in gas-fired electric generation he forecasts has not yet taken place.[70]

This PFD does not recommend that the Commission require the extensive analysis called for by the MCAAA at this point. Ms. Harvey's testimony is persuasive that the operational limitations foreclose such a strategy at the present time, and it also appears premature to conclude that the marketplace changes Mr. Peloquin forecasts will occur. Although Consumers Energy should not be required to undertake the requested analysis on the basis of this record, however, the Commission should

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[68] See 3 Tr 473-477.
[69] See 3 Tr 470-471.
[70] See 2 Tr 265-267. Consumers Energy also objects to the MCAAA's citation to a webpage not part of the record in this proceeding. See Consumers Energy reply brief, page 29. Based on the recommendations in this PFD, it is not necessary to address the company's arguments.

reasonably expect the company to monitor and be alert to potential changes in the gas market, as it develops or refines its gas purchasing strategies.

H. Price Spikes

In its reply brief, MCAAA urges that any gas purchasing guidelines "include some duty upon the utility to seek to avoid significant gas price spikes that may arise from short-term emergencies and from anomalies caused by market speculation." [71] MCAAA argues that if sufficient gas is purchased at favorable prices, or other planning tools are implemented, the utility can avoid or sharply curtail gas purchases when gas spikes occur:

> Moreover, a price spike should be identifiable when it is commencing and is in progress because the prices rise beyond reasonably sustainable levels, and because a price spike often occurs due to some event, such as a hurricane or other event that causes the temporary spike.[72]

The concept of "price spike" can reasonably be understood with reference to Exhibit AG-2, showing pricing peaks in approximately November 2005 and July 2008. Because MCAAA seeks this modification principally in its reply brief, none of the parties have had a chance to respond.

While a rote approach to gas purchasing without analysis of current market conditions could lead to significant purchases of gas during short-term "price spikes", there is no formula or guideline offered on this record that can be used to avoid such spikes. The company has indicated that it spreads out its purchases in any month to avoid purchasing too large a quantity at any one time or price, and has various operational plans for its storage fields to enable it to meet normal and colder-than-normal weather at various times throughout the winter. Since the company is aware of

[71] See reply brief, page 4.
[72] MCAAA reply brief, pages 4-5.

the concern, and since no more specific analysis or guidance was presented by MCAAA, this PFD does not recommend any modification of the guidelines to explicitly incorporate the concept of price-spike avoidance.

IV.

MONTHLY SALES ALLOCATIONS

In forecasting sales for the GCR year and five-year forecast period, Consumers Energy first projected annual sales, and then estimated monthly sales for each year based on a four-year history of monthly consumption patterns. In Case No. U-16149, the Commission reviewed the monthly sales forecasts, and concluded that an eleven-year history should be used.

Mr. Hollewa noted this decision in his testimony in this case, but acknowledged that the forecasts resulting from Consumers Energy's use of the four-year history did not differ significantly from forecasts using the longer period of data. Exhibit RRC-2 shows a comparison of the two approaches. Nonetheless, Mr. Hollewa recommended that in future cases, Consumers Energy be directed to provide both sets of projections as part of its filing:

> First, I recommend that the Company provide an Exhibit which includes the same data provided in Exhibit rrc-2, page 4, using a 4-year rolling average of the [monthly] allocation factors. This is desirable because the GCR Year Total is developed from the monthly allocated sales spanning the annual estimates from two years.
>
> Second, I recommend that the Company provide another Exhibit which includes the same data as provided in Exhibit RRC-2, pages 6 and 7, using an 11-year rolling average of the allocation factors. This is desirable because an 11-year average is much less sensitive than a 4-year average regarding any unusual monthly variation which could occur.

> The11-year summary of data on page 7 will also provide an update for the most recent year and the values used to calculate both averages.[73]

The RRC renews this request in its briefs, arguing that the Commission's prior decision should be respected. The Attorney General agrees.

In rebuttal testimony, Mr. Hubert W. Miller III opposed the RRC's recommendation:

> First, information needed to perform the analysis of the moving average proposed by the Company is contained in the exhibits already provided by the Company. The fact that Mr. Hollewa wants the Company to present information in a structure more convenient for him does not justify imposing it as a filing requirement. Preparing analyses not necessary to the Company's direct case should not be made an ongoing utility responsibility. Second, the discovery process is an effective and appropriate avenue for parties to request information not included in the Company's filing and not germane to its direct case. This is evident by the fact that Mr. Hollewa has included the Company's discovery responses as the exhibits beings referenced in his proposal.[74]

He also testified to his understanding that the Commission "didn't directly tell the Company to use [the eleven-month method] in the next case."[75]

In its briefs, Consumers Energy cites the following portion of the Commission's decision in Case No. U-15454:

> The Commission also agrees with Consumers that the task of preparing quantitative analyses of data not necessarily germane to the utility's direct case in an Act 304 proceeding should not be made an ongoing utility responsibility. As Consumers noted, Exhibit A-29 was only prepared by Consumers as rebuttal to an intervenor's position. There is no indication in this record that a similar issue will arise in a future case. In the event that a similar issue does arise in a future proceeding, an intervenor may seek the necessary information from Consumers through discovery or obtain it from an independent source.[76]

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[73] See 2 Tr 165.
[74] See 2 Tr 44.
[75] See 2 Tr 45.
[76] See February 3, 2009 order, page 13.

The company does not address the Commission's decision in Case No. U-16149, relied on by the RRC. In that case, the Commission described Consumers Energy's position as follows:

> Consumers further argues that the ALJ should have adopted its updated sales forecast, which uses a four-year historical allocation percentage method to allocate annual results to individual months. Consumers points out that the ALJ does not disagree with the company's annual sales forecast, but rather with how annual sales are allocated among individual months. Consumers objects to the 11-year average proposed by the RRC (for the five winter months) and recommended by the ALJ (for all 12 months). Consumers argues that it has shown that a four-year average using 2006-2009 more accurately reflects current customer usage patterns than an 11-year average. Consumers notes that the four-year average uses weather-adjusted sales, thus addressing the ALJ's concern that a few unusual months could introduce error. Consumers also notes that it made several changes to its sales forecast based on criticisms submitted by the RRC.[77]

The Attorney General's position is stated as follows:

> The Attorney General also supports using 11-year averages for allocating sales, but contends that the issue is moot in this case because it will have no material effect on projected GCR booked costs of gas sold, and that the Commission should therefore defer its decision until a future case where it will have an impact upon GCR costs.[78]

The ALJ in that case recommended adoption of the RRC's proposal. The Commission upheld the PFD: "[T]he Commission agrees with the ALJ, the Attorney General, and the RRC that the 11-year average for allocation of monthly sales is superior to the four-year average."[79]

Based on this review of the Commission's decision in Case No. U-16149, this PFD concludes that the Commission adopted the 11-year average for the allocation of monthly sales as a preferred method. On this basis, it is reasonable to expect

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[77] See December 21, 2010 order, page 14.
[78] Id. at page 11.
[79] Id. at page 13.

Consumers Energy to use that method in future cases, or provide justification for the change. Such justification should include a comparison of the approved 11-year average method with whatever alternative the company is proposing. Thus, this PFD recommends that the Commission direct Consumers Energy to use the 11-year average in its next plan case filing, or to provide justification for an alternative, with a comparison of the 11-year average, to the alternative proposed. Since the Commission addressed this issue directly in Case No. U-16149, the concern the Commission raised in Case No. U-15454 to avoid requiring studies not germane to the company's case is not applicable.

V.

GCR FACTOR CONTINGENCY MATRIX

Consumers Energy recommends that the Commission continue to include a "contingency ceiling price adjustment mechanism" in the company's tariff, which would permit the company to increase the GCR ceiling factor based on changes in NYMEX prices for the GCR year. Using the same method as followed in the company's last plan case, U-16149, Consumers Energy calculated a "multiplier" of .2873, presented in Ms. Harvey's Exhibit A-21, and a corresponding contingency adjustment matrix for NYMEX increases of up to $3.00 per Mcf, resulting in a maximum increase of $0.8619 per Mcf in the ceiling factor.[80]

The MCAAA and the Attorney General argue that the contingency ceiling price adjustment mechanism should be eliminated. The MCAAA argues that it is no longer necessary given a stable to declining projection for NYMEX prices, and further argues

[80] See Exhibit A-40, page 2.

that ceiling factor increases due to NYMEX changes have little relationship to Consumers Energy's actual cost of gas, add complexity to the tariffs and the public understanding of the tariffs, and the claimed benefits are erroneous or illusory.[81] Mr. Peloquin testified regarding the utility's concern for cash flow, accurate price signals, and the potential additional interest costs associated with underrecoveries.

The Attorney General also cites Mr. Peloquin's testimony, and focuses on the company's expectation of a stable market with stable to declining prices.[82]

In response to Mr. Peloquin's testimony, Ms. Rolling testified that the company does have a legitimate cash flow concern that the contingency mechanism helps address, since the company pays for gas when it is delivered, rather than when it is consumed. She also testified to the importance of sending accurate price signals, and indicated that the company manages its GCR factor each month, within the ceiling, to limit overrecoveries. She also emphasized that under the company's proposal, with the maximum increase of $3.00 per Mcf in the NYMEX price, the maximum GCR rate would be $7.3164 per Mcf.

In its briefs, Consumers Energy emphasizes that although it forecasts a stable to declining market for natural gas, "prices remain volatile and uncertain."[83] The company also cites the Commission's April 28 and November 30, 2005 decisions in Case No. U-14403, indicating that the purpose of the mechanism is to lessen underrecovery, and send accurate price signals, and further that a purposeful underrecovery is unreasonable.[84] Specifically addressing the Attorney General's

[81] See MCAAA brief, pages 2-22; reply brief, pages 2-4.
[82] See Attorney General brief, page 8; and see Howard, 3 Tr 311-313.
[83] See Rolling, 2 Tr 84.
[84] See Consumers Energy brief, 51-53; reply brief 25-28.

argument that price increases are not probable or highly likely, Consumers Energy argues that the statutory standard for a contingency factor does not require that the contingency be probable or highly likely.

This PFD recommends that the Commission continue to include the contingency mechanism for this GCR year, subject to reevaluation in each future plan case. The contingency mechanism does provide a backstop against significant underrecoveries, which may harm ratepayers both because of the additional interest costs and because of the potential to significantly raise rates in subsequent GCR years, unrelated to the cost of gas at the time.[85] Recognizing this, however, Mr. Peloquin's testimony is persuasive that consumers respond to "accurate pricing signals" based on long-term prices. There is an inherent tension between Consumers Energy's management of its factor on a month-to-month basis to avoid overrecoveries, and the stated desire for accurate pricing signals. To the extent monthly factors move unpredictably, ratepayers cannot identify or reasonably respond to those rates as price signals. Thus, this PFD recommends that in addition to directing the company to manage its factor to avoid significant underrecoveries, the company also be directed to manage its factor to avoid significant month-to-month variation.

VI.

AFFILIATE TRANSACTIONS

The MCAAA argues that the Commission should scrutinize affiliated transactions and adopt certain "ring-fencing" measures or remedies to protect ratepayers from

[85] Since historical refunds are not made to each customer on the basis of past usage, it is not productive to attempt to balance alternative interest rates consumers may face.

adverse impacts arising from affiliated transactions. The MCAAA relies in part on Mr. Peloquin's testimony:

> In order to ensure that CECo's base and Act 304 rates are minimized and are just and reasonable, and that CECo's costs arise from reasonable and prudent activities, policies, and practices, the Commission should direct that "ring-fencing" approaches be instituted with respect to CECo. In addition, the Commission should undertake review and audit or certain of CECo's affiliates to ensure against potentially abusive intercorporate transactions that may adversely impact CECo's costs and rates. The Commission's authority to undertake such audits and reviews is well grounded in the state statutes applicable to the Commission, but are now also buttressed by the provisions of federal law, including Section 1265 of the Public Utility Holding Company Act of 2005, 42 USC 1261 et seq., which is a part of the Energy Policy Act of 2005 (EPACT).[86]

The MCAAA's briefs also provide extensive discussion of the Commission's authority to protect ratepayers from adverse effects of affiliate transactions, including discussion of the Commission's statutory authority, and the Michigan Supreme Court's decision in *Union Carbide Corporation v Public Service Comm'n*, 431 Mich 118 (1988).

Exhibit MCAAA-1 contains excerpts from CMS Energy's Form 10K filed with the Securities and Exchange Commission. The MCAAA relies on this exhibit to show the numerous affiliates of Consumers Energy.[87] The MCAAA argues further: "The bottom line is that the CMS Energy/CECo holding system is vast and contains many scores of affiliates engaged in the same or related business functions which give rise to multiple opportunities for CMS to increase its profits under the guise of expenses of the utility, through the use of affiliate transactions." The MCAAA asks the Commission to "provide for enhanced reporting, audits, and review of affiliated transactions, and implementation

[86] See Peloquin, 2 Tr 254.
[87] See the MCAAA brief, pages 51-57.

of ring-fencing remedies, to protect ratepayers from the impact of transactions benefiting unregulated affiliates that may increase gas cost and rates to ratepayers."[88]

Consumers Energy in response relies on Mr. Howard's rebuttal testimony, asserting that Consumers Energy has not included costs associated with any affiliate transactions in its GCR plan, and has no plans to enter into such transactions in the plan year.[89] Mr. Howard further testified:

> Mr. Peloquin's suggestion that there may be potentially abusive intercorporate transactions between Consumers Energy's regulated gas business and unregulated subsidiaries or affiliates that might impact GCR costs and rates is unfounded and without valid basis. The activities of CMS Energy subsidiaries and affiliates do not affect the booked cost of GCR gas and do not make the existence of any fact that is of consequence to the determination of the booked cost of gas sold more or less likely. There are no conflicts between Consumers Energy's regulated gas business and unregulated subsidiaries or affiliates with respect to GCR cost of natural gas.[90]

Consumers Energy further argues in its reply brief that MCAAA's claim for relief is based on speculation regarding potential future transactions, and thus the MCAAA has not provided grounds for the relief it seeks. The Attorney General supports the company's argument.

This PFD recommends that the Commission reject the MCAAA's request for relief in this case. Based on Mr. Howard's testimony, there are no actual or proposed affiliate transactions affecting Consumers Energy's cost of gas. As the MCAAA argues in its brief, the Commission has ample authority to protect ratepayers from adverse affects associated with affiliate transactions. The MCAAA has not shown that the

[88] See the MCAAA brief, page 58.
[89] See 3 Tr 359-360.
[90] See 3 Tr 358-359.

Commission should take any particular protective actions based on the record in this case.

VII.

TRANSCRIPT CORRECTIONS

Consumers Energy filed transcript corrections on May 25, 2011. Although the Attorney General indicated in an email response that he intended to file objections to the proposed corrections, he did not do so. Therefore, in accordance with the MPSC rules of practice and procedure, this PFD approves the proposed transcript corrections, and provides the opportunity through exceptions and replies for the parties to raise any disputes with the Commission. The transcript corrections are the following:

1. At 3 Tr 371 line 8, strike "didn't" and insert "did".
2. At 3 Tr 390 line 2, strike "pullback" and insert "Globex".
3. At 3 Tr 402 line 2, strike "is" and insert "isn’t".
4. At 3 Tr 408 line 22, strike "Roush" and insert "Rouge".

VIII.

CONCLUSION

This PFD recommends that the Commission adopt the findings and recommendations set forth above. The recommendations relating to the company’s plan and five-year forecast can be summarized as follows. First, this PFD recommends that the Commission approve Consumers Energy’s plan for the GCR year 2010-2011, with the modifications to the fixed price purchase guidelines discussed below, and authorize a GCR ceiling factor of $6.4545 per Mcf, subject to the contingency factor matrix contained in Exhibit A-40.

With regard to the fixed price purchase guidelines, this PFD recommends two modifications applicable to the company's administration of the guidelines both in the current GCR year and in future GCR years: the company should retain discretion in the administration of the guidelines, including authority to deviate from the fixed price purchase percentages as discussed in section III.B above; and the guidelines should make clear that the annual caps on purchases under the quartile strategies are not independent, but function as described in section III.E above.

Regarding application of the fixed price purchase guidelines to purchases of gas for future GCR years, this PFD additionally recommends that the Commission indicate the following, based on present evidence: 1) the proposed revisions to the quartile strategies appear reasonable, except that the fourth year annual caps should not be increased over the levels established in Case No. U-15704; and 2) the portion of the tier strategy calling for accelerated purchases based on changes in the GCR cost of gas does not appear reasonable. Also, this PFD recommends that the company continue to evaluate the guideline strategies, and refine the pricing models used to test those strategies.

Although recommending approval of the company's monthly forecasts for the GCR year, this PFD recommends that Consumers Energy be directed to use the 11-year method in subsequent plan cases, or provide justification for an alternative method, including a comparison of the difference between methods.

Additionally, this PFD recommends that the Commission caution Consumers Energy regarding its bidding procedures, and the need for a minimum number of bids to establish that the prices it agreed to pay were negotiated through competitive bidding.

Finally, this PFD recommends that the Commission direct Consumers Energy to manage its GCR factor so as to both avoid overrecoveries and avoid significant month-to-month changes in the factor.

MICHIGAN ADMINISTRATIVE HEARING SYSTEM
For the Michigan Public Service Commission

Sharon L. Feldman

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Sharon L. Feldman
Administrative Law Judge

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